Supreme Court of the United States

OCTOBER TERM, 1943. No. .

METROPOLITAN LIFE INSURANCE COMPANY,
Petitioner,

vs.

ADRIAN ETTELSON, *et al.*,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

A.

The Opinions of the Courts Below.

The opinion in the Circuit Court of Appeals is not yet reported (R. page 71). The opinion of the District Court is reported in 42 Fed. Supp. 488.

In addition, the opinion of this Court on question certified is reported in 317 U. S. 188.

B.

Jurisdiction.

I.

The jurisdiction of this Court is sustained by Section 240 of the Judicial Code as amended by the Act of February 13, 1925, (U. S. C. A. Title 28, Sec. 347).

II.

The date of the judgment to be reviewed is June 29, 1943 (R. page 76).

III.

The grounds on which jurisdiction in this Court is invoked are:

a. The judgment of the Circuit Court of Appeals reversed the District Court and ordered the enforcement of petitioner's equitable right of cancellation and rescission of the policy under the counterclaim to be proceeded with before the court and jury in violation of its substantive right to a hearing before the court, sitting in equity. This decision is contrary to the ruling of this Court in *Erie Railroad Co.* v. *Tompkins,* 304 U. S. 64, and determines an important question of local law and procedure in a way in conflict with applicable local decisions. *Ruhlin* v. *New York Life Ins. Co.,* 304 U. S. 202.

b. In deciding that the ruling in *Erie Railroad Co.* v. *Tompkins, supra,* does not apply, the Circuit Court of Appeals has ignored the objective and policy disclosed in that case as bearing on the substantive rights of petitioner with respect to the burden of proof and the procedure under local law to enforce its equitable right to cancellation for innocent misrepresentations. *Cities Service Co.* v. *Dunlap,* 308 U. S. 208; *Sampson* v. *Channell,* 110 Fed. 2nd (C. C. A. 1) 754, page 756; cert. denied 310 U. S. 650.

c. The decision of the Circuit Court of Appeals is not in accord with applicable decisions of this Court. The peti-

tioner is demanding relief available to it in equity only, namely, a decree of cancellation of the policies. *Radio Corporation of America* v. *Raytheon Mfg. Co.*, 296 U. S. 459, page 462.

d. The decision of the Circuit Court of Appeals has created a situation which requires the settlement of the procedure by this court. The forum of a judge and jury cannot render a decree of cancellation. Petitioner in its counterclaim seeks more than to successfully defend the plaintiff's demand for money damages. It seeks the equitable remedy of cancellation, on a showing of material misstatements of facts innocently made and without fraudulent intent. If the decision of the Circuit Court of Appeals stands how shall the court and counsel in this, and subsequently similar cases proceed! How can the rights of a party seeking cancellation be enforced in the Federal District Court! A situation is clearly presented where questions of public importance are invoked which it is in the public interest to have decided by this court. *Magnum Co.* v. *Coty*, 262 U. S. 159.

Statement of the Case.

The case has been stated under heading "Summary Statement of the Matter Involved" in the Petition, page 1, and is not here repeated.

SUMMARY OF ARGUMENT.

1. The local (New Jersey) law enforces the equitable right of cancellation of a contract for fraud, only through an equity proceeding. The proof need only be that the material statements were false in fact, though innocently or unintentionally made. *Erie Railroad Co.* v. *Tompkins,* 304 U. S. 64, governs.

2. The Federal Court on the trial of the issue raised by petitioner's counterclaim must do exactly what the State Court sitting in its place would do.

3. The effect of the ruling of the Circuit Court of Appeals is to deny the petitioner a substantive right under Federal law and procedure.

4. The ruling of Circuit Court of Appeals that the equitable issue presented by the counterclaim should be tried by the court and jury constitutes such a departure from the accepted and usual course of judicial proceedings as to require settlement of the procedure by this Court.

ARGUMENT.

I.

A.

The local or New Jersey law enforces the equitable right of cancellation only through an equity proceeding.

The Circuit Court of Appeals held that *Erie Railroad Co. v. Tompkins,* 304 U. S. 64, "does not affect the procedure in the pending case" (R. page 74).

Petitioner sought the cancellation of the policies—a purely equitable right. There is a clear distinction between what elements must be proved to establish a legal defense of fraud as opposed to affirmative equitable relief for fraud. This amounts to something more than procedure. Under the law of New Jersey, the Court sitting in equity will grant the equitable relief of cancellation where the fraud consists of material representations false in fact, made without either knowledge of their falsity or intent to deceive; while on the other hand, the Court sitting as a court of law, will recognize fraud as a defense to an action to enforce payment under the contract only where the falsity was uttered knowingly and intentionally. The court of law has no power to decree cancellation.

In *Commercial Cas. Ins. Co.* v. *Southern Surety Co.,* 100 N. J. Eq. 92; aff'd on opinion 101 N. J. Eq. 738; 135 Atl. Rep. 511, the Court said at page 96:

> "In equity an untruthful representation of a material fact, though there be no moral delinquency, is

> deemed to be fraudulent. (Citing cases.) The law courts not having as yet taken upon themselves to relieve against wrongs resulting from misrepresentations fraudulent in conscience only, courts of equity continue to perform that function."

In *Metropolitan Life Ins. Co.* v. *Lodzinski,* 124 N. J. Eq. 357; 1 Atl. 2nd 859, the New Jersey Court of Errors and Appeals held at page 359:

> "It is true—as has been established by a long line of decisions—such rescission may be made in equity upon proof of reliance on material representations untrue in fact, without proof of conscious or intentional fraud."

In accord, *N. Y. Life Ins. Co.* v. *Weiss,* 133 N. J. Eq. 375; 32 Atl. R. (2) 341.

Hence the local law in New Jersey is:—at law, one must prove that the representations were false and were knowingly made, to sustain a defense, while in equity one need prove only that the representations were false in fact, although innocently made, to secure a cancellation of the contract. And it is settled by local law that the right to the affirmative equitable relief of cancellation and rescission of a contract can only be had in equity.

Metropolitan Life Ins. Co. v. *Tarnowski,* 130 N. J. Eq. 1; 20 Atl. Rep. (2) 421.

Commercial Cas. Ins. Co. v. *Southern Surety Co.,* 100 N. J. Eq. 92; aff'd on opinion, 101 N. J. Eq. 738; 135 Atl. Rep. 511.

Schoenfeld v. *Winter,* 76 N. J. Eq. 511; aff'd on opinion 79 N. J. Eq. 219; 74 Atl. Rep. 975.

In the *Schoenfeld* case the Court said at page 512:

> "In order to set aside a contract founded in fraud, it is only necessary in equity to prove that the representation upon which the action is founded is false, that it is material, and that damage has ensued; while at common law the proof must go to the extent of satisfying the jury that the defendant *knew* that the statement relied upon was false. It will therefore be seen at a glance that the remedy in equity is much broader and much more efficient than the remedy at law could be."

A mere defense to an action which prevents the plaintiff from recovering the judgment he seeks is not so full or ample or adequate a remedy as that of cancellation which forever places it beyond the power of the plaintiff to enforce or attempt to enforce his contract. In *New York Life Ins. Co.* v. *Steinman,* 103 N. J. Eq. 403; 143 Atl. Rep. 529, the Court said at page 404:

> "* * * the existence of a complete defense, based on fraud, in a court of law, falls short of and does not ordinarily constitute such an adequate remedy for the defendant as should impel a court of equity to refuse to entertain a bill filed by the defrauded party for cancellation and surrender of the contract, since the opportunity to make that defense may be lost, or the ability to make it may be weakened, by studied delay of the other party; and further, that mere defense at law does not embrace the equitable relief of cancellation or surrender of a contract."

B.

The question of whether scienter is a necessary element is closely allied with the questions of the burden of proof and procedure.

Since the plaintiff in a suit in equity for the cancellation of a contract under New Jersey law is relieved of the necessity of proving that the false statements were knowingly and purposely made, the questions of the burden of proof and procedure under local law become matters of substantive law.

In *Sampson* v. *Channell,* 110 Fed. 2nd (C. C. A. 1) 754, cert. denied, 310 U. S. 650, the Court said at page 756:

> "Inasmuch as the older decisions in the federal courts, applying in diversity cases the federal rule as to burden of proof as a matter of 'general law' are founded upon an assumption no longer valid since Erie Railroad Co. *v.* Tompkins, 304 U. S. 64, 58 S. Ct. 817, 82 L. Ed. 1188, 114 A. L. R. 1487, their classification of burden of proof as matter of substance should be re-examined in the light of the objective and policy disclosed in the Tompkins case."

Hence matters relating to the burden of proof and procedure may under local law become matters of substantive law.

Cities Service Co. v. *Dunlap,* 308 U. S. 208, was a bill in equity filed in the Federal District Court to remove a cloud on title to land. The Court below held that the doctrine of *Erie Raliroad Co.* v. *Tompkins* did not apply. This Court reversed and said at page 212:

> "We cannot accept the view that the question presented was only one of practice in courts of equity. Rather we think it relates to a substantial right upon which the holder of recorded legal title to Texas land may confidently rely. Petitioner was entitled to the protection afforded by the local rule."

In *Garrett* v. *Moore-McCormack Co.,* 317 U. S. 239, which was governed by the Merchant Marine Act rather than the local law, this Court held that the right of a seaman suing in a Pennsylvania Court under section 33 of the Merchant Marine Act to be free from the heavier burden of proof imposed by Pennsylvania law upon one attacking the validity of a written release is a right of substantive law inherent in his cause of action.

II.

This Court has held that in diversity of citizenship cases, except where a Federal statute governs, a Federal Court, whether trial or appellate, must do exactly what a State Court sitting in its place would do with the questions before it.

In *Ruhlin* v. *New York Life Ins. Co.,* 304 U. S. 202, this Court said that the doctrine of *Erie Railroad Co.* v. *Tompkins* applies, though the question of construction arises not in an action at law, but in a suit in equity.

In *New York Life Ins. Co.* v. *Jackson,* 304 U. S. 261, *Rosenthal* v. *New York Life Ins. Co.,* 304 U. S. 263, *Hudson* v. *Moonier,* 304 U. S. 397, and *Mutual Benefit H. & A. Association* v. *Bowman,* 304 U. S. 549, this Court remanded

the case to the courts below so that they might ascertain and apply the applicable state law.

In *Wichita Co.* v. *City Bank,* 306 U. S. 103, which involved the effect of a prior decision by the Texas Supreme Court as bearing upon the "law of the case", it was held that the Circuit Court of Appeals should give the same effect to the prior decision that a Texas state court would do.

In *United States* v. *Bethlehem Steel Corp.,* 315 U. S. 289, the District Judge, who had reversed the Master in allowing interest on the accounting, was upheld by this Court in applying the law of Pennsylvania.

In *Fidelity Union Trust Co.* v. *Field,* 311 U. S. 169, which was a suit for equitable relief, this Court held that in a diversity of citizenship case, the Court must follow the decisions of the New Jersey Court of Chancery in the absence of any decisions on the point by the Court of Errors and Appeals, and said at page 180:

> "* * * It is inadmissible that there should be one rule of state law for litigants in the state courts and another rule for litigants who bring the same question before the federal courts owing to the circumstance of diversity of citizenship. * * *"

The same rule was reiterated in *West v. Amer. T. & T. Co.,* 311 U. S. 223, in *Six Companies* v. *Highway District,* 311 U. S. 180, and in *Stoner* v. *New York Life Ins. Co.,* 311 U. S. 464.

In *Vandenbark* v. *Owens-Illinois Co.,* 311 U. S. 538, the District Court decided in accordance with the then existing

state decisions. Between its judgment and the hearing in the Circuit Court of Appeals, the State Supreme Court reversed its earlier decisions and laid down a contrary rule of law. This Court held that the Circuit Court of Appeals should have applied the state law, as existing at the time the case was before it, even though the District Court's decision was correct under the state law at the time it was made. Mr. Justice Reed stated at page 453:

> "While not insensible to possible complications, we are of the view that, until such time as a case is no longer *sub judice*, the duty rests upon federal courts to apply state law under the Rules of decision statute in accordance with the then controlling decision of the highest state court. Any other conclusion would but perpetuate the confusion and injustices arising from inconsistent federal and state interpretations of state law."

In *Klaxon Co.* v. *Stentor Co.*, 313 U. S. 487, this Court stated the principal question to be (Page 494) "whether in diversity cases the Federal Court must follow conflict of laws rules prevailing in the states in which they sit", and answered the question yes, saying at page 496:

> "Any other ruling would do violence to the principle of uniformity within a state, upon which the Tompkins decision is based."

To the same effect is *Griffin* v. *McCoach*, 313 U. S. 498.

Petitioner's case is not one where Federal Law must govern as in *Prudence Corp.* v. *Geist*, 316 U. S. 89, where this Court held the Bankruptcy Act, not local law, applied; or as in *B. & O. R. R. Co.* v. *Kepner*, 314 U. S. 44, where this Court held the Federal Employers Liability Act applied; or as in *Sola Electric Co.* v. *Jefferson Co.*, 317 U. S. 173.

III.

The effect of the ruling of the Circuit Court of Appeals is to deny the petitioner a substantive right under Federal law and procedure.

The Circuit Court of Appeals held in effect that whatever relief the petitioner is entitled to under its counterclaim is obtainable in a trial by court and jury. In so holding, the Court failed to distinguish between the right to defend at law and the right to affirmative equitable relief in equity in a case where the fraud consists of innocent misrepresentations.

The character of relief to which a party is entitled is a matter of substance. In *Black & Yates* v. *Mahogany Ass'n.*, 129 Fed. (2) 227 (C. C. A. 3, cert. den. 63 Sup. Ct. 76), the Court held at page 233:

> "As to substantive rights the cases are clear that the rules of substantive law to be applied in a federal equity court in a diversity case are those which would be applied in a state court sitting in the same state. This is a logical and indeed necessary extension of the principle of Erie R. Co. *v.* Tompkins, *supra.*" (Citing many of the cases *supra* under Point II.)

The correct application of the rule of procedure in affording relief is also a matter of substance. The Circuit Court of Appeals recognized that it is a close question as to whether the petitioner's rights under *Erie Railroad Co.* v. *Tompkins, supra,* are substantive or procedural (R. pages 72-73). Clearly they are substantive. Whether the State law or Federal law be applied, the enforcement of equitable

rights and remedies can only be through an equity, as opposed to a law, procedure, and this is a matter of substance.

We have seen that under local (New Jersey) law, the cancellation and rescission of contracts is only by a proceeding in equity. Point I A *supra*. The same must be true in the Federal Court, whether the question is considered strictly under Federal procedure or under *Erie R. R.* v. *Tompkins, supra.*

Where a United States District Court has jurisdiction in the sense of power to adjudicate a controversy, it has the same authority to grant equitable relief as that exercised by the English Court of Chancery in 1789.

> *Atlas Ins. Co.* v. *Southern, Inc.*, 306 U. S. 563, 568.
> *Gordon* v. *Washington*, 295 U. S. 30, 36.
> *Waterman* v. *Canal-Louisiana, Etc., Co.*, 215 U. S. 33, 43.

In *Atlas Ins. Co.* v. *Southern, Inc.*, 306 U. S. 563, this Court, in commenting on Section 24 (1) of the Judicial Code, 28 U. S. C. Section 41 (1) said at page 568:

> "The 'jurisdiction' thus conferred on the federal courts to entertain suits in equity is an authority to administer in equity suits the principles of the system of judicial remedies which had been devised and was being administered by the English Court of Chancery at the time of the separation of the two countries". (Citing cases.)

In *Whitehead* v. *Shattuck*, 138 U. S. 146, referring to Section 267 of the Judicial Code, 28 U. S. C. Section 384, this Court said at page 150:

> "The provision is merely declaratory, making no alteration whatever in the rules of equity on the subject of legal remedies, but only expressive of the law which has governed proceedings in equity ever since their adoption in the courts of England."

In *Radio Corporation of America* v. *Raytheon Mfg. Co.*, 296 U. S. 459, this Court laid down the rule that where equitable relief is demanded, the equitable issue must be disposed of at the beginning, and said at page 462:

> "True there are times when a release, unassailable at law, is voidable in equity, and in equity only. If the plaintiff were demanding relief upon that basis, the equitable issue would have to be disposed of at the beginning. American Mills Co. *v.* American Surety Co., 260 U. S. 360, 363; Liberty Oil Co. *v.* Condon National Bank, 260 U. S. 235, 242; Enelow *v.* New York Life Insurance Co., 293 U. S. 379, 383; Adamos *v.* New York Life Insurance Co., 293 U. S. 386. With the parties so arrayed, the situation would be the same as if a bill in equity had been filed to set aside the release, the suitor thus removing a bar to a recovery. Enelow *v.* New York Life Insurance Co., *supra*, p. 382. But the plaintiff disclaims any title to relief upon that basis."

On the contrary the petitioner here is demanding relief in equity.

It is settled by this Court that Federal Courts, sitting in equity, have power to and do act to cancel contracts obtained by fraud.

> *Smith* v. *Richards*, 38 U. S. (13 Peters) 26;
> *Turner* v. *Ward*, 154 U. S. 618.

A policy of insurance obtained by material statements, false in fact, but innocently or unintentionally made, is unassailable at law in New Jersey. Such contract can only be successfully attacked or defended against in equity. The motion to dismiss (R. page 50a) impliedly admits this. The Circuit Court of Appeals assumes it (R. page 72). This is a peculiarity of local procedure which this Court will recognize. *Atlas Ins. Co.* v. *Southern, Inc.*, 306 U. S. 563, at page 572. The Federal Court, applying local law under *Erie Railroad Co.* v. *Tompkins, supra,* must of necessity exercise its inherent equity power the same way.

IV.

The decision of the Circuit Court of Appeals is bound to work confusion in the practice of the lower courts and the procedure requires settlement by this Court.

The counterclaim here and any similar bill or counterclaim for the equitable remedy of cancellation and rescission based on innocent misrepresentations does and will involve more than a mere defense to the fraud. It may be, as the Circuit Court of Appeals holds, that a defense of fraud whether "legal" or "equitable" can be availed of at law in certain jurisdictions without distinction, although this is not so in New Jersey. In that State unintentional fraud or "honest misrepresentations" offer no defense at law and can only be availed of in equity. See Point I A *supra.*

In none of the cases cited by the Circuit Court of Appeals (R. page 75), namely *MacLanahan* v. *Universal*

Ins. Co., 1 Peters 170; *Carpenter* v. *American Ins. Co.*, 5 Fed. Cas. No. 2428; 1 Story CC 57; *Hazard* v. *New England Marine Ins. Co.*, 11 Fed. Cas. No. 6282; 8 Peters 457; *Carrollton Furniture Mfg. Co.* v. *American Credit Indemnity Co.*, 115 Fed. 77; 124 Fed. 25, was there any demand for equitable relief. They were all actions at law where the fraud, whether intentional or unintentional, was held to constitute a defense. *The Carrollton Furniture Co.* case cited three New York cases, indicating that the local New York law recognized unintentional fraud as a defense at law. Not so in New Jersey.

The rule that "fraud in the procurement of insurance is provable as a defense in an action at law upon the policy, resort to equity being unnecessary to render that defense available", as laid down by this Court in *American Life Ins. Co.* v. *Stewart,* 300 U. S. 203, page 212, is necessarily limited to conscious, not unintentional fraud, as in each of the cases cited to sustain the statement, the facts show the fraud to have been conscious and deliberate.

In the same *Stewart* case (300 U. S. at page 214), this Court said:

> " 'Where equity can give relief plaintiff ought not to be compelled to speculate upon the chance of his obtaining relief at law'. Davis *v.* Wakelee, 156 U. S. 680, 688. To this must be added the danger that witnesses may disappear and evidence be lost. A remedy at law does not exclude one in equity unless it is equally prompt and certain and in other ways efficient". (Citing cases.)

This is in line with the rulings of the New Jersey Courts. In *Commercial Cas. Ins. Co.* v. *Southern Surety Co., supra,* the Court said (100 N. J. Eq. 97):

> "It may be that the complainants would not be able to prove that the misrepresentations were knowingly false, but could only prove that they were material and untrue—a defense in equity only. The complainants are not to be put to the hazard at law when the requirements in equity are less exacting". (Citing Schoenfeld *v.* Winter, 76 N. J. Eq. 511, aff'd on opinion 79 N. J. Eq. 219; 74 Atl. Rep. 975.)

See Counterclaim, par. 23 (R. page 36a).

Therefore, if the rule of the Circuit Court of Appeals stands, there will be two distinct procedures in the New Jersey jurisdiction with respect to the defense of unintentional or equitable fraud. That in itself is contrary to the spirit of *Erie Railroad Co.* v. *Tompkins, supra.* Confusion must necessarily arise in the Federal Court for the New Jersey District. How shall the judge proceed? Shall he instruct the jury that "innocent misrepresentations" constitute a defense. If so, he runs counter to the local law. Shall he instruct the jury that they may render a verdict that the policies be cancelled. If so, he ascribes functions to the jury which are contrary to established law and procedure, both State and Federal. If in the Federal Court suits to cancel contracts obtained by fraud must be tried by the court and jury, the court is shorn of its power to cancel such contracts in equity.

Is it not obvious that the public interest requires that these tangled questions be settled by this Court!

The Circuit Court of Appeals in its decision in this case has departed from the accepted and usual course of procedure in suits seeking the equitable affirmative relief of the cancellation of a contract for fraud.

Wherefore it is respectfully submitted that the writ of certiorari prayed for should be granted.

CONOVER ENGLISH,
Of Counsel for Petitioner.